

# INDEX

	Page
Opinions below.....	1
Jurisdiction.....	1
Question presented.....	2
Statute and regulations involved.....	2
Statement.....	2
Argument.....	5
Conclusion.....	9
Appendix.....	10

## CITATIONS

### Cases:

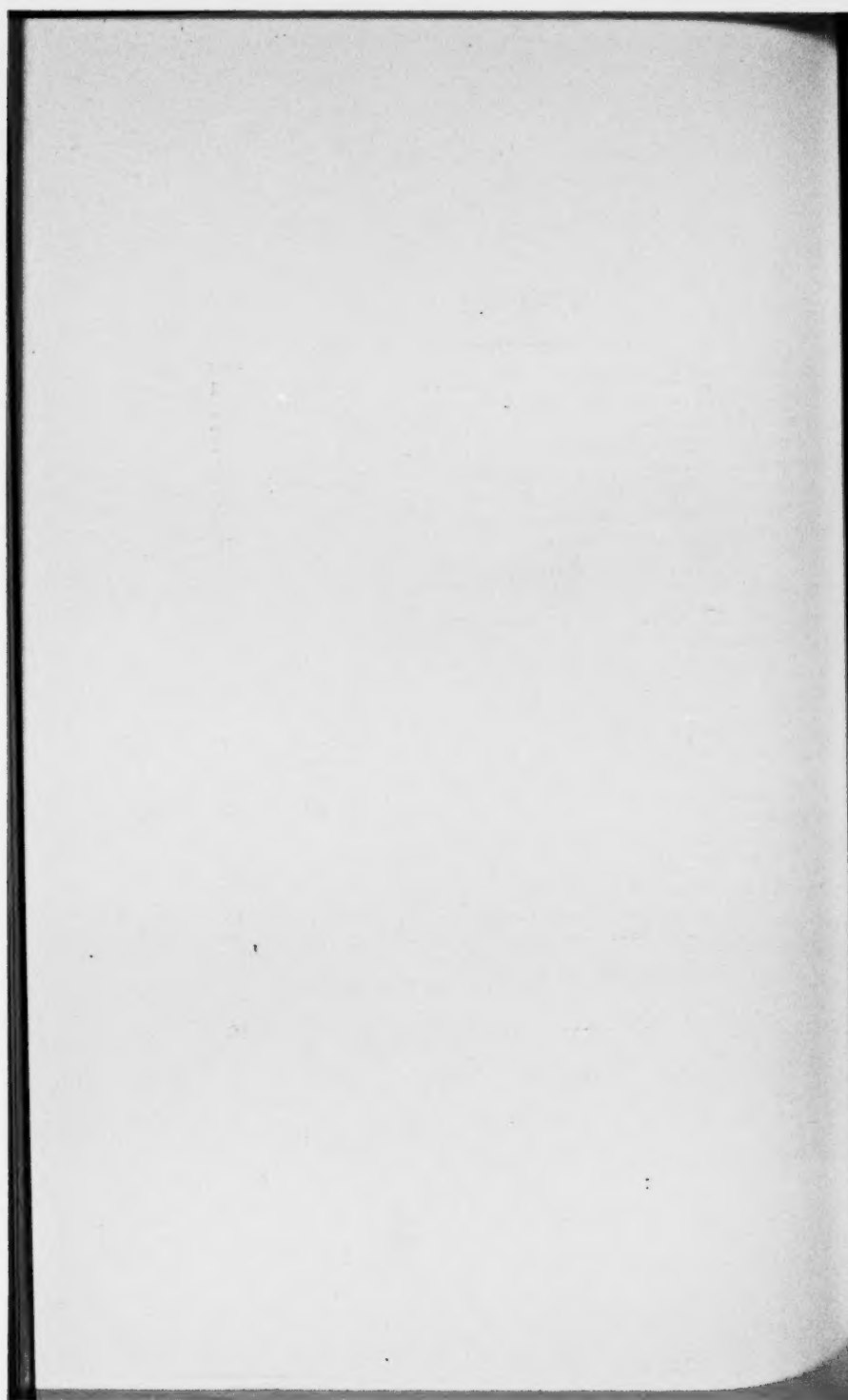
<i>Clark, C. C., Inc., v. United States</i> , 126 F. 2d 292.....	7
<i>Commissioner v. Dulup Oil Co.</i> , 126 F. 2d 1019.....	7
<i>Commissioner v. Michigan Silica Co.</i> , 41 B. T. A. 511, 124 F. 2d 397.....	8
<i>Commissioner v. Strong Mfg. Co.</i> , 124 F. 2d 360, reversed November 9, 1942.....	9
<i>Helvering v. Moloney Electric Co.</i> , 120 F. 2d 617, certiorari denied, 314 U. S. 682, rehearing denied, 315 U. S. 826.....	7
<i>Nevada-Massachusetts Co. v. Commissioner</i> , 128 F. 2d 347.....	7

### Statutes:

Revenue Act of 1926, c. 27, 44 Stat. 9:	
Sec. 22.....	8
Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Sec. 14.....	10
Sec. 26.....	5, 6, 10

### Miscellaneous:

Treasury Regulations 94, promulgated under the Revenue Act of 1936:	
Art. 26-2.....	12



# In the Supreme Court of the United States

OCTOBER TERM, 1942

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No. 472

CLOVER SPLINT COAL CO., INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL  
REVENUE

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR THE THIRD  
CIRCUIT*

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**BRIEF FOR THE RESPONDENT IN OPPOSITION**

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**OPINIONS BELOW**

The opinion of the Board of Tax Appeals (R. 15-29) is not officially reported. The opinion of the Circuit Court of Appeals (R. 33-39) is reported at 130 F. 2d 52.

**JURISDICTION**

The judgment of the Circuit Court of Appeals was entered August 19, 1942. (R. 39.) Petition for a writ of certiorari was filed October 22, 1942. The jurisdiction of this Court is invoked under

Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

**QUESTION PRESENTED**

During the first ten months of 1937 the taxpayer was prohibited by contract from paying dividends within the meaning of Section 26 (c) of the Revenue Act of 1936. That prohibition was lifted on November 1, 1937. Is the taxpayer entitled to a credit under Section 26 (c) with respect to the income received during the first ten months?

**STATUTE AND REGULATIONS INVOLVED**

The statute and regulations involved appear in the Appendix, *infra*, pp. 10-14.

**STATEMENT**

This case involves petitioner's liability for undistributed profits taxes with respect to the year 1937. The facts, as stipulated (R. 3-14) and as found by the Board of Tax Appeals (R. 15-23), may be summarized as follows:

Taxpayer, a coal mining company, executed a mortgage to trustees as of May 1, 1929, to secure an issue of notes maturing May 1, 1936, in the aggregate amount of \$500,000. The mortgage provided that taxpayer should deposit with the corporate trustee twenty-five cents for each ton of coal mined so long as the aggregate amount of notes outstanding exceeded \$300,000, and twenty cents for each ton of coal mined when

the aggregate amount of notes outstanding was less than \$300,000. (R. 4-5.)

The mortgage was subsequently modified by three indentures executed as of April 10, 1931, August 1, 1932, and August 20, 1934, respectively, by the taxpayer, the noteholders and the trustees. Each modification relieved taxpayer of some of the more immediate of its obligations under its mortgage, the net effect of all the amendments being to extend the maturity of taxpayer's notes to May 1, 1941, to relieve taxpayer from making sinking fund payments for the period May 1, 1932, to November 1, 1936, and to postpone and defer the dates for paying interest on some of the taxpayer's outstanding notes. (R. 6-10, 21.) These modifications were conditioned upon various stipulations, those pertinent to the taxable year 1937 being as follows (R. 10, 11, 21):

The said party of the first part shall make no payments in the nature of dividends to its stockholders except it shall have previously paid to the Corporate Trustee an amount which would have been equal to the amount of sinking fund payments that would have been paid under and by virtue of said mortgage dated the first day of May, 1929, and said indenture dated the 10th day of April, 1931, or, at the election of said Clover Splint Coal Company, after it shall have required [acquired] notes secured by said mort-

gage in an amount equivalent to such amount of sinking fund requirements.

\* \* \* \*

The Clover Splint Coal Company shall make no payments in the nature of dividends to its stockholders, except that it shall have previously paid all interest coupons upon said outstanding notes accruing during the period aforesaid and interest upon said coupons as hereinafter set forth.

During the entire year 1936, and during the first ten months of 1937, taxpayer was not able to meet the foregoing conditions precedent to the payment of dividends. (R. 11, 22.)<sup>1</sup> However, on November 1, 1937, the noteholders exchanged their notes for an issue of taxpayer's Prior Preference stock, the mortgage was cancelled, and taxpayer was released from its covenants with respect to the payment of dividends. (R. 22.) Between November 1 and December 31, 1937, taxpayer paid dividends in the amount of \$2,812.50 out of earnings subsequent to November 1, 1937, for which the Commissioner allowed a dividends paid credit. (R. 23.)

Taxpayer's income for the calendar year 1937 was \$51,759.95, after the allowance for depletion. (R. 35.) During the first ten months of 1937 taxpayer paid the corporate trustee \$98,204.77, which

<sup>1</sup> At the beginning of 1937, taxpayer had a deficit in the amount of \$435,614.86. (R. 23.)

was employed by the trustee, pursuant to the mortgage covenants, for the retirement of some of the notes and for the payment of interest upon the notes up to November 1, 1937. (R. 22-23.)

The Board of Tax Appeals held that taxpayer in computing its undistributed net income for the calendar year 1937, for the purposes of the surtax on its undistributed profits, was not entitled under Section 26 (c) to a credit in the amount of its income for the first ten months of the year 1937 and, accordingly, sustained the tax determined by the Commissioner against the taxpayer's undistributed net income for the year 1937. (R. 29.) The Circuit Court of Appeals affirmed the Board. (R. 39.)

#### ARGUMENT

1. The sole question under Section 26 (c) (1) of the Revenue Act of 1936 (Appendix, *infra*) is whether taxpayer could have distributed a sum equal to its adjusted 1937 net income, within the year, as dividends without violating a provision of a written contract executed prior to May 1, 1936, which provision "expressly deals with the payment of dividends". This, taxpayer plainly could do after November 1, 1937, and the Board of Tax Appeals and the Circuit Court of Appeals properly so held. It may be assumed that if the mortgage with its accompanying covenants had continued in existence throughout the calendar year 1937, the taxpayer would be entitled to the credit which it seeks. But the covenants were ex-

tinguished on November 1, 1937; during the remaining two months, therefore, it was free to distribute all of its 1937 earnings as dividends to its stockholders. Taxpayer contends, however, that its earnings for the first ten months had already been exhausted, so that the statute could operate only upon the earnings of the last two months. But there is nothing in the record to show that the \$98,204.77 paid to the trustee during the first ten months must be charged against the earnings for that period. For aught that appears the earnings remained intact and available for distribution after November 1, 1937. In these circumstances the court below did not err in holding Section 26 (c) (1) inapplicable.

2. Nor is taxpayer entitled to the credit claimed under Section 26 (c) (2). Taxpayer was obligated to pay interest on its secured notes at the stipulated rate, whether or not it had earnings or profits. But its contractual obligation to pay interest did not "expressly" deal with "the disposition of [its] earnings and profits of the taxable year" and require *them* to be paid in discharge of or to be irrevocably set aside within the taxable year for the discharge of the interest. Indeed, taxpayer does not make such a contention here.

So, too, taxpayer's obligation to make sinking fund payments to the trustee, at a certain rate per ton for each ton of coal mined, was an obligation entirely without reference to earnings or profits

during the year, and operated though taxpayer might have no earnings or profits during the year, and whether or not the taxpayer sold any coal whatever that year. Taxpayer's obligation for these payments was conditioned solely upon tonnage production. Thus it did not expressly deal with "the disposition of [taxpayer's] earnings and profits of the taxable year" 1937, and it did not by express provision require earnings and profits "to be paid within the taxable year in discharge \* \* \* or to be irrevocably set aside within the taxable year for the discharge of a debt". *Helvering v. Moloney Electric Co.*, 120 F. 2d 617 (C. C. A. 8th), certiorari denied, 314 U. S. 682, rehearing denied, 315 U. S. 826; *Commissioner v. Dulup Oil Co.*, 126 F. 2d 1019 (C. C. A. 5th). See also *C. C. Clarke, Inc. v. United States*, 126 F. 2d 292 (C. C. A. 5th); *Nevada-Massachusetts Co. v. Commissioner*, 128 F. 2d 347 (C. C. A. 9th).

To taxpayer's final argument—in substance that its mortgage by implication deals with the disposition of its earnings and profits of the taxable year—it suffices to answer that Section 26 (c) (2) requires, as a condition to any credit, that the contract provision "expressly deal" with the disposition of the year's earnings and profits. This the taxpayer's mortgage did not do, and the Circuit Court of Appeals so noted, saying (R. 38-39):

"The mortgage indenture upon which the taxpayer here relies does not \* \* \* expressly or by implication deal with the disposition of earnings and profits."<sup>2</sup>

There is no conflict with *Commissioner v. Michigan Silica Co.*, 124 F. 2d 397 (C. C. A. 6th). The Silica Company's engagement, as shown by the finding and opinion of the Board of Tax Appeals (41 B. T. A. 511), was to pay for sinking fund purposes to its trustee, by the tenth of each month, 25 cents "for each ton of sand produced and sold" by it during the preceding month (p. 513). The Board thought (pp. 514-515) that the trust indenture dealt expressly with the disposition of earnings and profits of the taxable year "since the amounts which were required to be paid into the sinking fund in the taxable year were based upon the receipts of the petitioner from the sale of its sand". But whatever may be said of the correctness of that ruling, it is inapplicable here; for payments into the sinking fund in this case were to be measured by production irrespective of whether there were any gross receipts. Moreover, the present status of the *Michigan Silica Co.* case is open to serious doubt: it had been decided *per*

<sup>2</sup> In support of its implication argument taxpayer represents (Pet. 11, Br. 27-28) that its income tax liability for the year 1937 has been and is determined by the use of coal inventories. (See Section 22 (c) Revenue Act of 1926.) The record, as we view it, does not justify any such conclusion of fact, particularly in an appellate court.

*curiam* on authority of *Commissioner v. Strong Mfg. Co.*, 124 F. 2d 360 (C. C. A. 6th), decided the same day, which was subsequently reversed by this Court, November 9, 1942, No. 41, present Term.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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